United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1573-A

H. PERINE,

Plaintiff-Appellant,

-against-

WILLIAM NORTON & COMPANY, INC., WILLIAM NORTON, ELINORE NORTON and DESIGNCRAFT JEWEL INDUSTRIES, INC.,

Defendants

ON APPEAL FROM UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PLAINTIFF-APPELLANT'S BRIEF

STATEMENT OF ISSUES

The issue upon this appeal is whether an underwriter who purchases and sells more than 10% of the issuer's outstanding common stock is liable under Section 16(b) of the Securities Exchange Act of 1934 to return his short-swing profits where the underwriter failed to comply with SEC Regulation 16b-2 (17 CFR

§240.16b-2) exempting, upon certain conditions, underwriting profits from 16(b) in that the underwriter failed to comply with the condition that he share upon the same terms that he enjoys at least one-half of the underwriting with other non-insider underwriters.

STATEMENT OF THE CASE

A. PRELIMINARY STATEMENT

This is a derivative action brought by a stockholder of Designcraft Jewel Industries, Inc. ("Designcraft") *(A 2) pursuant to Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78p) (set forth, infra, in Appendix A to this brief) to recover the short-swing "insider" profits made by William Norton & Company, Inc. ("Norton"), a broker-dealer, in the purchase and sale of Designcraft's common stock. In the course of a firm-commitment underwriting or public offering of Designcraft's common stock, Norton, purchased and sold at a profit, within a period of six months, over 10% of Designcraft's outstanding common stock.

Upon plaintiff's motion for partial summary judgment on the issue of liability and Norton's cross-motion for summary judgment

*References to "A" are to the Joint Appendix herein.

the court below (Ward, J.) entered judgment in favor of Norton (A 57). Plaintiff appeals to this Court from such judgment in favor of Norton. (A 58).

The opinion of the Court below is reported at 372 F. Supp. 341.

While the complaint names as defendants William Norton and Elinore Norton (the stockholders of Norton at the times material herein) plaintiff was unable to serve these defendants because they had left the country for an indeterminate period of time, had no domestic addresses, and their addresses abroad were unknown to plaintiff.

B. THE FACTS

At all material times herein, Designcraft was registered, pursuant to Section 12(g) of the 1934 Act (15 U.S.C. §781(g)), with the Securities and Exchange Commission as an "over-the-counter" company so that 16(b) was applicable to Designcraft's equity securities (A 17). On May 23, 1972, a registration statement for a public offering of 300,000 shares of Designcraft's common stock became effective (A 23). The total outstanding common stock of Designcraft, inclusive of the newly issued shares being sold in the public offering, consisted of 817,500 shares of stock (A 16).

The public offering of 300,000 shares of Designcraft was upon a firm-commitment basis (A 24). Norton's commitment was to purchase and sell 250,000 shares of Designcraft's common stock (A 24). A second broker-dealer or underwriter had the commitment to purchase and sell the remaining 50,000 shares of Designcraft's common stock (A 24).

In the course of the underwriting or public distribution, all 300,000 shares of Designcraft's stock were sold (A 25). The stock was purchased by Norton and the second broker-dealer for $10.24 per share and sold to the public for $11.25 per share, except those shares sold by Norton and the second broker-dealer to dealers at a smaller profit or spread (A 16, A 23-A 24).

Norton thus purchased and sold at a profit 250,000 shares of Designcraft's common stock----well over 10% of Designcraft's total outstanding common --- within a period of six months.

Plaintiff contended below, as he does upon this appeal, that the provisions of 16(b) for the recapture of short-swing profits made by insiders (i.e., directors, officers, and 10% beneficial stockholders) are plainly applicable here. Plaintiff further contended below, as he does here, that SEC Regulation 16b-2, (set forth, infra, in Appendix B), exempting, upon certain conditions, profits made by broker-dealers in underwritings or public

offerings from the recapture provisions of 16(b) is plainly inapplicable here because Norton had failed to satisfy the express condition that it share, upon the same terms that it enjoyed, at least one-half of the underwriting or offering with other broker-dealers who were not insiders within the purview of 16(b).

In its opinion herein in favor of Norton, the court below stated that the SEC's releases respecting its Regulation 16b-2 (the underwriters' exemption) "indicate that the Commission also does not consider an underwriter of a large block of securities [over 10%] an insider solely by virtue of a single underwriting venture, but understands the provision to refer only to underwriters with some [pre-existing insider] connection to the issuing corporation" (A 44). Plaintiff contends upon this appeal that precisely the contrary is correct, that is, that the SEC's releases, as well as other public statements of the SEC, expressly and specifically set forth the SEC's position that an underwriter, such as Norton, which purchases and sells over 10% of an issuer's stock is subject to recapture provisions of 16(b) unless it complies with the conditions of the exemption contained in Regulation 16b-2, including the condition that it share upon the same terms that it enjoyed at least 50% of the underwriting with other broker-dealers who are not themselves insiders within the purview of 16(b).

On or about April 2, 1974, after the entry of judgment herein, the SEC instituted administrative proceedings against Norton and certain other broker-dealers. The SEC's notice of hearing (set forth, infra, Appendix D) charged, among other things, that Norton carried (i.e., circulated) a misleading prospectus in respect of Designcraft in that the prospectus failed to disclose that Norton was artificially manipulating the market price of Designcraft's stock (Appendix D, pp.4,5) and further that Norton, aided and abetted by other broker-dealers, effected market transactions in Designcraft's stock while artificially manipulating the market price of Designcraft's stock (Appendix D,pp.5,6). Such manipulation is of course prime inside information and the possibility of the abuse of inside information for private profit at public expense is evident in such circumstances.

POINT I

NORTON IS LIABLE UNDER 16(b) FOR THE SHORT-SWING PROFITS THAT IT MADE IN THE PURCHASE AND SALE OF DESIGNCRAFT'S COMMON STOCK.

The purpose of 16(b) is to "deter insiders from trading on the basis of information unavailable to the general public" and, toward this end, "[i]t provides that whenever a director, officer or owner of ten percent or more of any class of an

issuer's securities purchases and sells equity securities of that issuer within a six-month period, he must return any profits he realizes to the issuer. There are no other prerequisites or postulates to liability." Newmark v. RKO General, Inc., 425 F. 2nd 348, 350-1 (2nd Cir. 1970), cert. denied, 400 U.S. 854.

The liability of 16(b) is "based upon an objective measure of proof"; the "application of the act is not conditional upon proof of an insider's intent to profit from unfair use of information...or upon proof that the insider was privy to any confidential information...Rather, Section 16(b) liability is automatic, and liability attaches to any profit by an insider on any short-swing transaction embraced within the arbitrarily fixed time limits of the statute." Feder v. Martin-Marietta Corporation, 406 F. 2d 260, 262 (2nd Cir. 1969), cert. denied, 396U.S. 1036.

This Court has also specifically stated through now Chief Burger, that, "the purpose of the statute is remedial, rather than penal and...it must be strictly construed in favor of the corporation and against any person who makes profit dealing in the corporation stock", Adler v. Klawans, 267 F. 2d 840 846-7 (2nd Cir. 1959), and further that, "The judicial tendency,

especially in this circuit, has been to interpret Section 16(b) in ways that are most consistent with the legislative purpose, even departing where necessary from the literal statutory language." Feder v. Martin Marietta Corporation, supra, 406 F. 2d, at p. 262.

Against the backdrop of these principles, we turn to the application of Section 16(b) in this case.

A.

An underwriter who, as here, makes a firm-commitment public offering of stock is of course a person who purchases and sells stock. Such purchase and sale involve all the regular risks of the market place. As has been said: "The actual placement [of the stock by the underwriter] in the hands of the public may require only a day or two or, if difficulties are encountered, possible several months. It is also possible that the issue will never be successfully placed." Robinson, Going Public, pp.49-50 (2nd ed. (Eppler) 1973).

As a matter of ordinary financial prudence and also in order to satisfy its legal responsibility under the Securities Act of 1933 (15 U.S.C. §§77a, 77k) for the accuracy of the registration statement, an underwriter is compelled to make a thoroughgoing investigation of the affairs of the issuer before

undertaking to purchase and sell the issuer's securities. Such investigation is described in Robinson, Going Public, supra, as follows:

> "The investigation by Livingston Brothers [the underwriter] is conducted to enable them to acquire sufficient data on which to base a decision as to whether they can profitably underwrite the issue. Livingston Brothers will study the prospects of the building industry in general and the electrical supply and construction industry in particular. They will ascertain the economic health of the geographical area served by Transtronics [the issuer] and the possibilities of an expanding market there for its products and services. They will study Transtronics' position in the industry and make an appraisal of its ability to meet competition. They will analyze the company's past earnings record and its current financial position. They will assess the additional earnings which Transtronics may expect from an infusion of additional working capital. They will check out its engineering standards and potential productioncapacity. They will carefully investigate the background and performance record of management. In this connection, they will want, in addition to credit reports such as those issued by Dun & Bradstreet, a special investigative report of the top management personnel. They will also ask for references and will send representatives to Transtronics' bankers, major suppliers and others. They will visit the company's premises and evaluate the efficiency of its operation in relation to its competitors' operations. After an analysis of these and related factors Livingston Brothers' representative will be able to give Abel [a principal of the issuer] an opinion as to whether Transtronics should offer common stock and, if so, how the stock would be received in the current state of the market." (pp. 52-53)
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> * * *
>
> "Assuming the issue is of such a nature as to require a full registration, it now becomes necessary for the underwriter and the company to call upon the assistance of

experts. The company will retain an independent certified public accounting firm satisfactory to the underwriter to make a thorough audit of the corporation and to submit a detailed report. Engineers will be employed to judge the condition of the company's plant and equipment and appraisers will be retained to verify the values of property. Counsel's opinions will be sought as to the legal effect of franchise agreements, patents, titles, contracts, and the like." (p.59)

* * *

"After the underwriters have received and distributed copies of the "red herring" preliminary prospectus and a few days before the public sale is to take place, a so-called "due diligence" meeting will be held. In the key example, this meeting will be organized by Livingston Brothers. In attendance will be Messrs. Abel and Baker [the principals of the issuer] as well as Transtronics' Treasurer, Harold Thomas, Counsel for the company, counsel for the underwriter, those representatives of Livingston Brothers who have done the investigation with respect to Transtronics, and a representative of Transtronics' independent auditors, will also be present. In the audience will be representatives of each of the underwriting houses and perhaps representatives of other investment banking firms who may be considering joining the syndicate or becoming selling dealers." (p. 160)

* * *

"At the 'due diligence' meeting, the partner of Livingston Brothers who is in charge of the underwriting will describe the proposed issue. He will advise concerning the expected date that the public sale is to be commenced, discuss the states in which qualification under blue sky laws is to be made, indicate the approximate expected issue price and spread and introduce the management of Transtronics. Mr. Abel will then make a speech describing the history and current business of his company. Then everyone will

look at the red herring prospectus and ask whatever questions come to mind.
"It has recently become the practice for counsel for the company, together with counsel for the underwriter, to hold an additional, private due diligence meeting with the principals of the company, the auditor and representatives of the managing underwriter. In this private session, each sentence of the prospectus is analyzed and questioned as to whether it is still true and not misleading. A last minute review of the affairs of the company is undertaken to make sure that its financial condition and business prospects have not materially changed since the date of the financial statements included in the prospectus and since the writing of the prospectus was originally concluded." (pp.161-162)

The negotiation of the spread (the underwriters' profit) involves hard bargaining between the issuer and the underwriter, Robinson, supra, pp. 53-54, with one of the principal factors involved in setting the amount of the spread being of course the risks involved to the issuer in purchasing and selling the stock. Id., at pp. 53, 197. Here, the spread was unusually high in that it was almost 10% and, in addition, bargain warrants were issued by Designcraft to Norton and the other broker-dealer (A 23-A 24).

B.

Ever since this Court's decision almost two decades ago in Stella v. Graham Paige Corp. Motors Corp., 232 F. 2d 299, 300-301 (2nd Cir. 1956), cert. den., 352 U.S. 83, it has been settled in this Circuit that a person who, within six months,

purchases and sells at a profit 10% or more of an issuer's stock is liable under Section 16(b). In other words, Section 16(b) includes the very purchase which makes the stockholder a 10% beneficial owner. See, similarly, Newmark v. RKO General, Inc., supra, 425 F. 2d at pp. 355-6 and Emerson Electric Co. v. Reliance Electric Co., 434 F. 2d 918, 922-4 (8th Cir. 1970), aff'd, 404 U.S. 418.

In its amicus brief (pp. 5-6) filed with the District Court in Stella in support of this result (and referred to in this Court's decision in Stella, 232 F. 2d at p. 301), the SEC stated: "A person who acquires a large block of stock in a single transaction normally has access to inside information. He necessarily would deal in the negotiations looking toward the purchase, with either the issuer or an insider holding a large interest in the issuer. In either event he would be in a position to bargain for disclosures not available to the public. It is against abuse of information so obtained as well as of information obtained after representation in management is secured that the section is directed." And in Newmark v. RKO General, supra, 425 F. 2d 356, this Court stated that the "statutory reference to a ten percent beneficial owner rests on the presumption that an owner of this quantity of securities has access to inside

information".

Such statutory presumption of inside knowledge is particularly appropriate where, as here, an underwriter engages in a firm-commitment underwriting. Indeed, in the particular case at bar, the distinct possibility exists, in view of the SEC's charges against Norton (infra, Appendix D,pp.5-7), that there was an actual abuse of inside information by Norton in the purchase and sale of Designcraft's stock, even though actual abuse is not necessary to liability under the objective standard of 16(b).

In the absence therefore of any applicable exemption for underwriters either in the statute or the SEC's regulations, an underwriter stands liable under 16(b) to the same extent as any other person who purchases and sells 10% or more of an issuer's stock. Section 16 itself contains no exemption for underwriters. On the contrary, the only exemption in the statute for broker-dealers is the so-called market-makers exemption of 16(d) which exempts transactions made by a dealer "in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market" in over-the-counter securities that are not held by the dealer in an investment account. Section 16(d) was added in 1964 when Section 16

was made applicable to the securities of over-the-counter companies.

The market-makers exemption of Section 16(d) is of course in no wise applicable to underwritings. Rather, that matter--the interaction between Section 16(b) and underwritings--has been specifically covered by the SEC Regulation ever since 1935. (See, infra, Appendix C, setting forth, in chronological order, all of the SEC's Regulations, together with accompanying releases, on the so-called underwriter's exemption, except for the present Regulation 16b-2 which is set forth, infra, in Appendix B.)

SEC Regulation 16b-2 provides that any transaction "effected in connection with the distribution of a substantial block of securities", i.e., an undertaking, "shall be exempt from the provisions of Section 16(b)...upon the following conditions", one of such conditions being that "Other persons not within the purview of Section 16(b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person [the insider underwriter] is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of Section 16(b) of the Act by this rule." Regulation 16b-2 thus expressly provides that an underwriter is exempt from the recapture provisions of 16(b) only if other broker-dealers who are not insiders within the contemplation of 16(b) participate upon equal

terms in at least half of the underwriting. See II Loss, Securities Regulation, p. 1113 (1961 ed.). As the SEC stated in its release issued in 1947, the purpose of such condition in the Regulation is "to prevent such 'insiders' or 'insider firms' from acquiring a preferential position where they participate in a distribution" (infra, Appendix C, p. 32). Such condition also serves to deter conduct by an insider underwriter involving abuse of inside information and manipulative activities (charged by the SEC to have occurred in the very underwriting involved in this case) in that equal participation by non-insider underwriters greatly reduces the incentive for engaging in such conduct while at the same time greatly increasing the risk of detection or exposure. In this connection, it should be noted that the exemption of Regulation 16b-2 is not only for underwritings but also for stabilizing activities conducted in connection therewith.

As originally promulgated in 1935, the Regulation (par. (a)) exempted only the underwriting of stock acquired from an "issuer" (infra, Appendix C, p. 26). In 1936, the Regulation was amended so as to define "issuer" to include "any person directly or indirectly controlling or controlled by the issuer, or any person or any person under direct or indirect common

control with the issuer". (Infra, Appendix C, p. 28).

As was explained in the accompanying release of the SEC, this amendment of the term "issuer" in the Regulation "enlarges the scope of the original exemption by making it available, on specified conditions, to any person who, with a view to distribution, acquires more than 10% of the equity securities of the issuer from its parent, subsidiary, or commonly controlled affiliate, or from individuals in similar relationships to the issuer" (infra, Appendix C, p. 27) (underlining supplied). In its opinion herein, the court below stated that the "rule, as originally promulgated, clearly indicated that its purpose was to exempt underwriters who, prior to the underwriting transaction, had some [pre-existing] 'insider' status" (A 47) and that nothing in the SEC's subsequent releases "indicated a shift to the viewpoint that an underwriter could become an insider simply by virtue of its distributing activities" (A 51). On the contrary, as seen, the SEC specifically stated in its 1936 release that the Regulation, if complied with, provided an exemption to the otherwise applicable provisions of Section 16(b) to an underwriter who "with a view to distribution, acquires more than 10% of the equity securities of the issuer."

Thus, in its amicus brief (pp.6-7) filed with the District Court in the Stella case, the SEC stated the following:

> "The Commission, at least by implication, early recognized that the Congress intended to include such purchases within the scope of the Act. Acting pursuant to the authority granted it to exclude from the operation of section 16(b) such transactions as 'are not comprehended within the purposes of Section 16(b)' it promulgated a rule, on June 8, 1935, exempting underwriting transactions meeting certain conditions from the liabilities imposed by the section. Such an exemptive rule would not have been necessary, insofar as underwriters who became 10 per cent owners of the securities underwritten by virtue of their underwriting agreement were concerned, unless section 16(b) is given the literal construction we have suggested. Subsequent amendments of this rule, in 1936 and 1938 [and 1952], did not vary this interpretation. It is apparent, therefore, that the Commission has consistently, for 17 years, regarded the purchase by which a stockholder achieved a ten per cent interest in the corporation as subject to the liabilities imposed by the section."

To the same effect, see article written by Chairman and an attorney of the SEC after District Court's decision in Stella: Cook and Feldman, "Insider Trading under the Securities Exchange Act", 66 Harvard L. Rev. 385, 612, 631-632, footnote 197 (1953).

C.

While Section 16 exempts the market-making transactions of a broker-dealer, it contains no exemption whatever for the underwriting transactions of a broker-dealer, this being a matter that has been covered almost since the very enactment of the 1934 Act by SEC Regulation. Regulation 16(b)-2 extends an exemption from 16(b) liability to underwriters who satisfy the conditions

that are prescribed in the Regulation. There is nothing whatever in Regulation 16b-2 to suggest that the liability under 16(b) of an underwriter who fails to satisfy the prescribed conditions is different from the liability of any other person under 16(b).

The effect of the decision by the court below is to carve out a special exemption for underwriters from 16(b) liability of far-reaching significance even though neither Section 16 itself nor Regulation 16b-2 (specifically treating the question of the underwriters' exemption) provides for any such exemption. The court below does this upon the ground that the SEC's releases indicate that such an exemption was intended, though of course the SEC could easily have provided for such exemption in a much less Delphic fashion in Regulation 16b-2 itself if such had in fact been the SEC's intendment. The actual fact however, is that the SEC's releases and its other official statements expressly and specifically make it clear that no such exemption was ever intended but that, just to the contrary, an underwriter, such as Norton, which purchases and sells over 10% of an issuer's stock is subject to the recapture provisions of 16(b) unless it satisfies the condition of Regulation 16b-2, including the condition that it share upon the same terms that it enjoys one-half of the underwriting with other non-insider underwriters. In the words, for example, of the SEC's release (infra, Appendix C, p.27)

16(b) liability attaches to an underwriter who "with a view to distribution, acquires [and sells] more than 10% of the equity securities of the issuer."

It accordingly follows that Norton is liable under 16(b) for the short-swing profits that it made in the purchase and sale of Designcraft's common stock.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment herein in favor of defendant Norton should be reversed, with appropriate directions to enter judgment in favor of plaintiff upon the issue of liability.

Respectfully submitted,

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July 3, 1974

APPENDIX "A"

SECTION 16b

[¶ 20,421] DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS

Sec. 16. (a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month. [As amended by Act of August 20, 1964, Sec. 8(a), 78 Stat. 579.]

[¶ 20,422] [Profits Realized from Purchase and Sales within Period of Less than Six Months]

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

[¶ 20,423] [Sales of Securities Not Owned or Not Delivered within Twenty Days]

(c) It shall be unlawful for any such beneficial owner, director, or officer, directly or indirectly, to sell any equity security of such issuer (other than an exempted security), if the person selling the security or his principal (1) does not own the security sold, or (2) if owning the security, does not deliver it against such sale within twenty days thereafter, or does not within five days after such sale deposit it in the mails or other usual channels of transportation; but no person shall be deemed to have violated this subsection if he proves that notwithstanding the exercise of good faith he was unable to make such delivery or deposit within such time, or that to do so would cause undue inconvenience or expense.

[¶ 20,424] [Exemption of Securities Held by Dealer as Market Maker]

(d) The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase, and the provisions of subsection (c) of this section shall not apply to any sale, of an equity security not then or theretofore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 5 of this title) for such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest, define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market. [As added by Act of August 20, 1964, Sec. 8(b), 78 Stat. 579.]

[¶ 20,425] [Exemption of Foreign and Domestic Arbitrage Transactions]

(e) The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section. [As amended by Act of August 20, 1964, Sec. 8(b), 78 Stat. 579.]

APPENDIX "B"

SEC REGULATION 16b-2

For IMMEDIATE release Friday, December 4, 1959

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 6131 J6V

AMENDMENT OF RULES 16b-2 AND 16c-2 UNDER
THE SECURITIES EXCHANGE ACT OF 1934

On October 29, 1959, in Securities Exchange Act Release No. 6103, the Securities and Exchange Commission announced a proposal to amend its Rules 16b-2 and 16c-2 under the Securities Exchange Act of 1934. The Commission has reviewed the comments and suggestions received on the proposal and has adopted the amendments as set forth below.

Section 16(b) of the Act provides that any profit realized by a beneficial owner of more than 10% of any class of any equity security registered on a national securities exchange or by a director or officer of the issuer of such a security (sometimes referred to herein as "insiders") as a result of any non-exempt short-swing transaction (purchase and sale, or sale and purchase, within six months) may be recovered by the issuer or by any security holder on its behalf. Section 16(c) of the Act makes it unlawful for the "insiders" referred to, directly or indirectly, to sell any non-exempted equity security of such issuer (1) if they do not own the security sold, or (2) if owning it, they do not deliver it within the period specified in the section. Rules 16b-2 and 16c-2 have provided exemptions from the above provisions for certain distributing transactions under specified conditions including, among others, the requirement that persons other than "insiders" be participating in the distribution to an equal extent and on terms at least as favorable as the "insiders".

The amendments to the above rules are intended to make it clear that when the conditions of the rules are met, certain other transactions which frequently occur in connection with distributions are also exempted. These include (1) stabilizing transactions, which may involve the purchase of outstanding securities of the same class rather than securities of the block being distributed, or, where a convertible security is being distributed, outstanding securities of the class subject to the conversion right; (2) transactions effected in connection with the various types of rights offerings, e.g. "lay offs" in a Shield's Plan type of distribution; and (3) transactions in connection with so-called standby redemptions, i.e., where convertible securities selling above their redemption price are called for redemption and at the same time arrangements are made under which dealers undertake to purchase any such securities tendered at a price slightly higher than the redemption price, to convert them, and to distribute the underlying stock.

Rule 16c-2 has also been amended to delete the requirement that the distribution be made on behalf of the issuer or a person in a control relationship with the issuer, a requirement which is not contained in Rule 16b-2. It is believed that where all of the other conditions of the rule can be met the identity of the person on whose behalf the distribution is being made is not a material consideration in determining whether the exemption should be available.

Statutory Basis

The Securities and Exchange Commission, acting pursuant to the provisions of the Securities Exchange Act of 1934, particularly Sections 3(a)(12), 16(b), 16(c), and 23(a) thereof, hereby amends Rules 16b-2 and 16c-2 as stated below. The Commission deems such action necessary and appropriate in the public interest and for the protection of investors and necessary to carry out its functions under the Act. The Commission finds, in accordance with the provisions of Section 4(c) of the Administrative Procedure Act, that this action has the effect of granting exemption and may be and is hereby declared effective December 4, 1959.

The text of Rule 16b-2, as amended, is as follows:

"Rule 16b-2. Exemption from Section 16(b) of Certain Transactions Effected in Connection with a Distribution.

"(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of Section 16(b) of the Act, to the extent specified in this rule, as not comprehended within the purpose of said section, upon the following conditions:

"(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

"(2) The security involved in the transaction is (A) a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities, or (B) a security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed or to cover an over-allotment or other short position created in connection with such distribution; and

"(3) Other persons not within the purview of Section 16(b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of Section 16(b) of the Act by this rule. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this rule.

"(b) The exemption of a transaction pursuant to this rule with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this rule."

The text of Rule 16c-2, as amended, is as follows:

"Rule 16c-2. Exemption from Section 16(c) of Certain Transactions Effected in Connection with a Distribution.

"Any security shall be exempt from the operation of Section 16(c) of the Act to the extent necessary to render lawful under such section any sale made by or on behalf of a dealer in connection with a distribution of a substantial block of securities, upon the following conditions:

"(a) The sale is represented by an over-allotment in which the dealer is participating as a member of an underwriting group, or the dealer or a person acting on his behalf intends in good faith to offset such sale with a security to be acquired by or on behalf of the dealer as a participant in an underwriting, selling or soliciting-dealer group of which the dealer is a member at the time of the sale, whether or not the security to be so acquired is subject to a prior offering to existing security holders or some other class of persons; and

"(b) Other persons not within the purview of Section 16(c) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such dealer is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of Section 16(c) of the Act by this rule. However, the

performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this rule."

By the Commission.

Orval L. DuBois
Secretary

APPENDIX "C"

SEC REGUIATIONS RE:
UNDERWRITERS SINCE 1935

For Release in MORNING NEWSPAPERS of Saturday, June 8, 1935.

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 264 (Class B)

The Securities and Exchange Commission today made public a rule exempting certain transactions by underwriters from the provisions of Section 16 (b) of the Securities Exchange Act. This subsection of the Act requires a person who is the beneficial owner of more than 10 per cent of an equity security registered on a national securities exchange, or an officer or director of the issuer of such a security, to account to the issuer for profits made by purchases and sales of any equity securities of the issuer made within a six-months period.

The new Rule NB2 affords an exemption for certain cases by providing that underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company, provided that independent underwriters have a participation in the underwriting of at least 50 per cent on identical terms. No exemption, however, is granted from the requirements of Section 16(a) which calls for a full disclosure of those transactions.

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For Release in MORNING NEWSPAPERS of Saturday, June 8, 1935

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 264 (Class A)

The Securities and Exchange Commission, finding that the transactions described in the following rule are not comprehended within the purpose of Section 16 (b), as set forth in said subsection, hereby adopts said rule as Rule NB2:

Rule NB2. Exemption from Section 16 (b) of Certain Distributing and Underwriting Transactions. Any transaction of purchase and sale of a security shall be exempt from the provisions of Section 16 (b), to the extent prescribed in this rule, as not comprehended within the purpose of said subsection, upon condition that:

(a) The person effecting such transaction purchases such security, with a view to the distribution thereof, from a person (1) who is the issuer thereof, or (2) who is participating in good faith in the distribution of the same issue of securities and whose ownership of such security has been acquired within six months, directly or solely through other such participants, from the issuer;

(b) Such transaction is effected by a person who is otherwise engaged in the business of buying and selling securities for his own account, through a broker or otherwise, as a part of a regular business; and

(c) If the person effecting such transaction is either (1) an officer or director of the issuer, (2) a firm of which such officer or director is a partner, or (3) a corporation or other person in respect of which such officer or director is an officer, director or beneficial owner, directly or indirectly, of more than 10 per cent of any class of equity security, then other persons who are not specified in clauses (1), (2) or (3), of this paragraph (c) must have participated in the purchase of such security (or other securities of the same issue) with a view to the distribution thereof, on terms identical with those on which such specified persons have participated and to an amount at least equal to the aggregate participation of all such specified persons.

The exemption of a transaction pursuant to this rule with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the requirements of paragraphs (a), (b), and (c) of this rule.

---oOo---

For INMEDIATE Release Thursday, March 19, 1936.

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 535 (Class B)

The Securities and Exchange Commission has amended Rule NB2, making two changes in its provisions. The rule exempts from Section 16(b) of the Securities Exchange Act of 1934, transactions of certain underwriters who otherwise would be accountable to issuing companies for profits realized in the distribution of such companies' securities. The rule is applicable to individuals acting as underwriters if they are officers, directors, or principal stockholders of the issuer, and to underwriting corporations or firms if they are principal stockholders of the issuer.

As originally adopted, it provided that if the underwriter was a corporation or firm of which an officer, director, member or principal stockholder was also an officer or director of the issuer, it need not account to the issuer for profits realized in the distribution of a security for the company, provided that other and independent underwriters have a participation in the underwriting of at least 50% on identical terms.

The first change limits the original exemption by extending the specified interlocking relationships to include officers and directors of issuers serving as employees, appointees, nominees, or representatives of the underwriters. This change is to become effective April 20, 1936 but will not apply to distributions begun prior to that date.

The second change in the rule enlarges the scope of the original exemption by making it available, on specified conditions, to any person who, with a view to distribution, acquires more than 10% of the equity securities of the issuer from its parent, subsidiary, or commonly controlled affiliate, or from individuals in similar relationships to the issuer. This second change is to become effective immediately.

---oOo---

For INMEDIATE Release Thursday, March 19, 1936

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 535 (Class A)

The Securities and Exchange Commission, finding that the transactions described in Rule NB2, as hereinafter amended, are not comprehended within the purpose of subsection (b) of Section 16 as set forth in said subsection, hereby amends said Rule by:

1. Inserting immediately after the word "partner", in clause (2) of paragraph (c), the words "employee, appointee, nominee, or representative,";

2. Inserting immediately before the words "or beneficial owner" in clause (3) of paragraph (c), the words "employee, appointee, nominee, representative"; and

3. Inserting a new paragraph immediately following paragraph (c), to read as follows:

"As used in paragraph (a) of this rule, the term 'issuer' shall include, in addition to an 'issuer' within the meaning of Section 3 (a) (8), any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. As used in this rule, the term 'issue ' shall include, in addition to an issue of securities issued by an issuer within the meaning of Section 3 (a) (8), securities purchased with a view to distribution by the participants in any single distribution from any person directly or indirectly controlling or controlled by the issuer thereof, or from any person under direct or indirect common control with the issuer."

The Rule, as amended, reads as follows:

Rule NB2. Exemption from Section 16 (b) of Certain Distributing and Underwriting Transactions. Any transaction of purchase and sale of a security shall be exempt from the provisions of Section 16 (b), to the extent prescribed in this rule, as not comprehended within the purpose of said subsection, upon condition that:

(a) The person effecting such transaction purchases such security with a view to the distribution thereof, from a person (1) who is the issuer thereof, or (2) who is participating in good faith in the distribution of the same issue of securities and whose ownership of such security has been acquired within six months, directly or solely through other such participants, from the issuer;

(b) Such transaction is effected by a person who is otherwise engaged in the business of buying and selling securities for his own account, through a broker or otherwise, as a part of a regular business; and

(c) If the person effecting such transaction is either (1) an officer or director of the issuer, (2) a firm of which such officer or director is a partner, employee, appointee, nominee or representative, or (3) a corporation or other person in respect of which such officer or director is an officer, director, employee, appointee, nominee, representative or beneficial owner, directly or indirectly, of more than 10 per centum of any class of equity security, then other persons who are not specified in clauses (1), (2) or (3), of this paragraph (c) must have participated in the purchase of such security (or other securities of the same issue) with a view to the distribution thereof, on terms identical with those on which such specified persons have participated and to an extent at least equal to the aggregate participation of all such specified persons.

As used in paragraph (a) of this rule, the term "issuer" shall include, in addition to an "issuer" within the meaning of Section 3 (a) (8), any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. As used in this rule, the term "issue" shall include, in addition to an issue of securities issued by an issuer within the meaning of Section 3 (a) (8), securities purchased with a view to distribution by the participants in any single distribution from any person directly or indirectly controlling or controlled by the issuer thereof, or from any person under direct or indirect common control with the issuer.

The exemption of a transaction pursuant to this rule with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the requirements of paragraphs (a), (b), and (c) of this rule.

Paragraphs numbered 1 and 2 of the above amendment shall become effective upon April 20, 1936, but shall not apply to distributions begun prior to that date.

Paragraph numbered 3 of the above amendment shall become effective immediately.

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For IMMEDIATE Release Saturday, February 27, 1937

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 1080

Amendment to Rule NB2

The Securities and Exchange Commission, deeming the transactions described in Rule NB2 as hereinafter amended, to the extent prescribed in said rule as so amended, not to be comprehended within the purpose of sub-section (b) of Section 16 as set forth in such sub-section, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly Sections 16(b) and 23(a) thereof, hereby amends Rule NB2 by striking out of paragraph (c) of said Rule the words "identical with" and substituting in lieu thereof the words "at least as favorable as".

Paragraph (c) of Rule NB2 as so amended reads as follows:

"(c) If the person effecting such transaction is either (1) an officer or director of the issuer, (2) a firm of which such officer or director is a partner, employee, appointee, nominee or representative, or (3) a corporation or other person in respect of which such officer or director is an officer, director, employee, appointee, nominee, representative or beneficial owner, directly or indirectly, of more than 10 per centum of any class of equity security, then other persons who are not specified in clauses (1), (2) or (3), of this paragraph (c) must have participated in the purchase of such security (or other securities of the same issue) with a view to the distribution thereof, on terms at least as favorable as those on which such specified persons have participated and to an extent at least equal to the aggregate participation of all such specified persons."

The foregoing action shall be effective immediately upon publication.

By the Commission.

Francis P. Brassor,
Secretary.

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For IMMEDIATE Release Saturday, October 1, 1938

SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 1887

REDESIGNATION OF GENERAL RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934

ADOPTION OF RULE X-5

The Securities and Exchange Commission has adopted for its General Rules and Regulations under the Securities Exchange Act of 1934 a system of designation which indicates the particular sections of the Act to which the respective rules relate. The rules are now available, with the new designations, in printed pamphlet form.

The Commission has also adopted a new rule which provides that where reference has been made to rules under the old system of designation, such reference shall be deemed to refer to the respective rules under the new system of designation. The application of this rule will be temporary since the old designations will be superseded by the new as the various regulations in which such references occur are reprinted.

The text of the Commission's action follows:

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly section 23(a) thereof, and deeming such action necessary and appropriate in the public interest and for the protection of investors and necessary for the execution of the functions vested in the Commission, hereby takes the following action:

1. The Commission hereby adopts for its General Rules and Regulations under the Act the arrangement and system of designation followed in the attached printed copy of "General Rules and Regulations under the Securities Exchange Act of 1934."

2. The Commission hereby adopts the following new rule:

"Rule X-5. Reference to Rule by Obsolete Designation.

"Wherever in any rule, form, or instruction book specific reference is made to a rule by number or other designation which is now obsolete, such reference shall be deemed to be made to the corresponding rule or rules in these General Rules and Regulations."

The foregoing action shall be effective as of September 10, 1938.

By the Commission.

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For IMMEDIATE Release Wednesday, January 29, 1947

SECURITIES AND EXCHANGE COMMISSION
Philadelphia

SECURITIES EXCHANGE ACT OF 1934
Release No. 3907

The Securities and Exchange Commission today announced the adoption of a similar interpretative amendment to each of two rules, X-16B-2 and X-16C-2. These rules conditionally exempt underwriting transactions from Sections 16 (b) and 16 (c) of the Securities Exchange Act of 1934. Section 16 (b) is the section which provides that any profit realized by a beneficial owner of more than ten percent of any class of any equity security registered on a national securities exchange, or by a director or officer of the issuer of such a security, as a result of any purchase and sale (or sale and purchase) of any equity security of such issuer within a period of less than six months shall inure to the corporation. Section 16 (c) prohibits short sales of such equity securities by such persons. The two rules exempt bona fide underwriting transactions by dealers who fall within one of the three classes of "insiders" specified in Section 16, or by dealer firms with which such persons are connected. However, in order to prevent such "insiders" or "insider firms" from acquiring a preferential position where they participate in a distribution, the exemptions afforded by the two rules are subject to the condition that "non-insiders" or "non-insider firms" shall have participated in the distribution "on terms at least as favorable" as those on which the "insiders" have participated and "to an extent at least equal to the aggregate participation" of all "insiders."

The purpose of the present amendments is to make it clear that the mere receipt of a fee as manager of an underwriting syndicate shall not be deemed to destroy any exemption which would otherwise be available under the rules. (In addition, several minor changes of phraseology are being made in Rule X-16B-2 in order to conform its language to the more recently adopted Rule X-16C-2.)

The text of the Commission's action follows:

The Securities and Exchange Commission deems it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors to amend the first paragraph of part (c) of Rule X-16B-2 and the first paragraph of part (b) of Rule X-16C-2 under the Securities Exchange Act of 1934 to read as set forth below. The Commission finds that the amendments are primarily in the nature of interpretations of the existing provisions of the rules; that the amendments relieve restriction; that notice and public procedure pursuant to Section 4 (a) and (b) of the Administrative Procedure Act are unnecessary; and that the amendments may be declared effective immediately pursuant to Section 4 (c) of that Act. Therefore the Commission, pursuant to the authority conferred upon it by the Securities Exchange Act of 1934, particularly Sections 3 (a) (12), 16 (b) and (c) and 23 (a) thereof, hereby takes the following action:

I. The first paragraph of part (c) of Rule X-16B-2 is amended to read as follows:

"(c) If the person effecting such transaction is either (1) an officer or director of the issuer, (2) a firm of which an officer or director of the issuer is a partner, employee, appointee, nominee or representative, or (3) a corporation or other person in respect of which an officer or director of the issuer is an officer, director, employee, appointee, nominee, representative or beneficial owner, directly or indirectly, of more than 10 per centum of any class of equity security, then one or more other persons who are not specified in clause (1), (2) or (3) of this paragraph shall have participated in the distribution as members of the underwriting group on terms at least as favorable as those on which such specified persons have participated and to an extent at least equal to the aggregate participation of all such specified persons: Provided, That performance of the functions of manager of a distributing group and the receipt from the group of a bona fide payment for performing such functions shall not be deemed to destroy an exemption which otherwise would be available pursuant to this rule."

II. The first paragraph of part (b) of Rule X-16C-2 is amended to read as follows:

"(b) The exemptions granted by paragraph (a) shall be subject to the condition that, if the dealer is either (1) an officer or director of the issuer, (2) a firm of which an officer or director of the issuer is a partner, employee, appointee, nominee or representative, or (3) a corporation or other person in respect of which an officer or director of the issuer is an officer, director, employee, appointee, nominee, representative or beneficial owner, directly or indirectly, of more than 10 per centum of any class of equity security, then one or more other persons who are not specified in clause (1), (2) or (3) of this paragraph shall have participated in the distribution as members of the underwriting group (or, in the case of the second exemption, the underwriting group or the selling group or both) on terms at least as favorable as those on which such specified persons have participated and to an extent at least equal to the aggregate participation of all such specified persons: Provided, That performance of the functions of manager of a distributing group and the receipt from the group of a bona fide payment for performing such functions shall not be deemed to destroy an exemption which otherwise would be available pursuant to this rule."

Effective January 29, 1947

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For IMMEDIATE Release Wednesday, September 24, 1952

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 4754A 3/

ADOPTION OF AMENDMENTS TO RULES X-16A-1,
X-16A-3, X-16A-4, X-16B-2, X-16B-3 AND X-16B-5

Purpose of Rule

On June 18, 1952, the Commission published notice that it had under consideration proposals for the adoption of a new rule X-16A-8 and amendments to rules X-16A-1, X-16A-3, X-16A-4, X-16B-2, and X-16B-5. It invited all interested persons to comment upon the proposals. The notice of rules X-16A-1, X-16A-3 and X-16A-4 was published in Securities Exchange Act Release No. 4718. The notice of rules X-16B-2 and X-16B-5 was published in Securities Exchange Act Release No. 4719. The notice of rule X-16A-8 was published in Securities Exchange Act Release No. 4720. The amendment to rule X-16B-3 was suggested by comments received upon the proposed amendment to rule X-16A-1. The Commission has considered all comments and suggestions received in connection with the proposed rules and has determined that rules X-16A-1, X-16A-3, X-16A-4, X-16B-2, X-16B-3, and X-16B-5 should be adopted in the forms set forth below. The new rule X-16A-8 is still under consideration.

The amendments clarify and enlarge the reporting requirements and exemptions provided by section 16 (a) and section 16 (b) of the Securities Exchange Act. Section 16 (a) requires beneficial owners of more than 10 per cent of any class of equity registered on a national securities exchange and officers and directors of the issuers of such a security to file reports with the exchange and with the Commission indicating the extent of their beneficial ownership and any changes in such ownership which occur. Section 16 (b) provides, in general, for the recovery of profits realized by such persons when they effect purchases and sales or sales and purchases of such equity securities within any period of less than six months.

The new rule X-16A-1 requires the holders of options, puts, calls, spreads and straddles to file the reports required by section 16 (a). The new rule X-16A-3 requires any person who is a member of a partnership which owns securities of an issuer of which he is an officer, director, of ten per cent stockholder to report all holdings and all changes in the beneficial ownership of equity securities of that issuer held by the partnership. It is not intended as a modification of the principles governing liability for short-swing transactions under section 16 (b), as set forth in the case of Rattner v. Lehman, 193 F. 2d 564. But it is based upon the

belief that full disclosure requires a report of all partnership transactions when an officer, director or ten per cent stockholder of the issuer is a partner. The new rule X-16A-4 clarifies the prior rule by indicating that the exemption provided in the rule is applicable only when the securities were held by the persons enumerated in the rule. It also reduces the period of time during which the exemption is effective from two years to one year.

The new rule X-16B-2 broadens the prior rule by providing that the exemption is available for transactions of purchase and sale of securities in the course of a distribution of a block of securities on behalf of a security holder not standing in a control relationship to the issuer, as well as to other public distributions where the transactions are in the course of a public distribution of an issue of securities on behalf of an issuer, or a person who does stand in a control relationship to the issuer. The amendment to rule X-16B-3 broadens the exemption hitherto provided by the rule by making it applicable to acquisitions of nontransferable options, as well as to acquisitions of shares of stock. The new rule X-16B-5 merely clarifies the prior rule, and does not change its effect.

The Commission has concluded not to adopt the proposed revision of rule X-3B-2 as set forth in its notice, dated June 18, 1952 (Securities Exchange Act Release No. 4718, June 18, 1952). The comment received upon this proposal has convinced the Commission that adoption of the proposed revision would lead to undue uncertainties as to just what persons are to be treated as "officers" for purposes of sections 16 (a) and 16 (b), as well as sections 12, 13 and 14 of the Act. It has concluded that it should adhere to the definition in rule X-3B-2 as presently in effect, despite the intimations in the opinion of the Court in Colby v. Klune, 178 F. 2d 872, that the existing definition may be too narrow. The Commission is advised that that case is still awaiting trial upon remand to the district court. See also Lockheed Aircraft Corporation v. Rathman, F. Supp. (S.D. Cal.) decided July 21, 1952.

Although the Commission is continuing in effect the existing rule X-3B-2 as the Commission's definition of "officer," it is recognized that the ultimate determination of what constitutes an "officer" must be made by the courts and that the opinion in Colby v. Klune, 178 F. 2d 872, indicates the possibility that the provisions of the Act applicable to officers may be held to reach a broader class of persons than might otherwise appear from the definition contained in rule X-3B-2. Persons inquiring as to their statutory responsibilities will continue to be advised of this possibility.

Statutory Basis

The new rules are adopted pursuant to the authority vested in the Commission by the Securities Exchange Act of 1934, particularly sections 3(a)(12), 3(b), 16(b) and 23(a).

TEXTS OF RULES

The texts of the rules hereby adopted are as follows:

Rule X-16A-1. Reports under Section 16(a).

(a) . . . .

(h) For the purposes of this rule the acquisition or disposition of any transferable option, put, call, spread, or straddle shall be deemed such a change in the beneficial ownership of the security to which such privilege relates as to require the filing of a report reflecting the acquisition or disposition of such privilege. Nothing in this subparagraph, however, shall exempt any person from filing the reports required upon the exercise of such option, put, call, spread, or straddle.

Rule X-16A-3. Manner of Reporting Holdings and Changes in Ownership under Rule X-16A-1.

(a) . . . .

(b) A partner who is required under Rule X-16A-1 to report in respect of any equity security owned by the partnership shall include in his report the entire amount of such equity security owned by the partnership. He may, if he so elects, disclose the extent of his interest in the partnership and the partnership transactions.

Rule X-16A-4. Exemptions from Sections 16(a) and 16(b).

(a) During the period of twelve months following their appointment and qualification, securities held by the following persons shall be exempt from sections 16(a) and 16(b):

(1) Executors or administrators of the estate of a decedent;

(2) Guardians or Committees for an incompetent; and

(3) Receivers, trustees in bankruptcy, assignees for the benefit of creditors, conservators, liquidating agents, and other similar persons duly authorized by law to administer the estate or assets of other persons.

After the twelve month period following their appointment or qualification the foregoing persons shall be required to file reports with respect to the securities held by the estates which they administer

under section 16(a) and shall be liable for profits realized from trading in such securities pursuant to section 16(b) only when the estate being administered is a beneficial owner of more than 10 per cent of any class of equity security (other than an otherwise exempted security) which is listed on a national securities exchange.

(b) Securities reacquired by or for the account of an issuer and held by it for its account shall be exempt from sections 16(a) and 16(b) during the time they are held by the issuer.

Rule X-16B-2. Exemption from Section 16(b) of Certain Distributing Transactions.

(a) Any transaction of purchase and sale of a security which is effected in the distribution of a substantial block of securities of the same class shall be exempt from the provisions of Section 16(b) of the Act, to the extent specified in this rule, as not comprehended within the purpose of said section, upon the following conditions:

(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

(2) The security involved in the transaction is a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities; and

(3) Other persons not within the purview of Section 16(b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which the person effecting the transaction is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of Section 16(b) of the Act by this rule. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this rule.

(b) The exemption of a transaction pursuant to this rule with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this rule.

Rule X-16B-3. Exemption from Section 16 (b) of Certain Acquisitions of Securities under Stock Bonus or Similar Plans.

Any acquisition of shares of stock or non-transferable options (other than convertible stock or stock acquired pursuant to a transferable option, warrant or right) by a director or officer of the issuer of such stock shall be exempt from the operation of Section 16(b) of the Act if the stock or option was acquired pursuant to a bonus, profit-sharing, retirement or similar plan meeting all of the following conditions:

(a) The plan has been approved specifically, or through the approval of a charter amendment authorizing stock for issuance pursuant to the plan, by the security holders of the issuer at a meeting for which proxies were solicited in accordance with such rules and regulations, if any, as were then in effect under Section 14(a) of the Act.

(b) If the selection of the persons who may receive funds or securities pursuant to the plan, or the determination of the amount of funds or securities which may be so received by any such person is subject to the discretion of any person, such discretion shall be exercised by (1) a committee of three or more persons having full and final authority in the matter, or (2) the board of directors of the issuer, provided the members of such committee, or a majority of the directors acting in the matter, are not entitled to participate in such plan or in any other similar plan provided by the issuer or any of its affiliates.

(c) The plan effectively limits the aggregate amount of funds or securities which may be allocated with respect to each fiscal year pursuant to the plan, either by limiting the maximum amount which may be allocated to each participant in the plan or by limiting the maximum amount which may be so allocated to all such participants.

(d) The acquisition of the securities pursuant to the plan does not involve the payment of any cash (other than the application of funds currently received pursuant to the plan or payable pursuant to the option contract) directly or indirectly, to the issuer or any of its affiliates.

Rule X-16B-5. Exemption from Section 16(b) of Certain Transactions in which Securities are Received by Redeeming Other Securities.

Any acquisition of an equity security (other than a convertible security or right to purchase a security) by a director or officer of the issuer of such security shall be exempt from the operation of Section 16(b) upon condition that

(a) the equity security is acquired by way of redemption of another security of an issuer substantially all of whose assets other than cash (or government bonds) consist of securities of the issuer of the equity security so acquired, and which

(1) represented substantially and in practical effect a stated or readily ascertainable amount of such equity security,

(2) had a value which was substantially determined by the value of such equity security, and

(3) conferred upon the holder the right to receive such equity security without the payment of any consideration other than the security redeemed;

(b) no security of the same class as the security redeemed was acquired by the director or officer within six months prior to such redemption or is acquired within six months after such redemption;

(c) the issuer of the equity security acquired has recognized the applicability of paragraph (a) of this rule by appropriate corporate action.

* * * * *

The foregoing rules shall become effective November 1, 1952.

By the Commission.

(SEAL)

Orval L. DuBois,
Secretary.

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APPENDIX "D"

SEC NOTICE OF HEARING
RE: DESIGNCRAFT

Administrative Proceeding
File No. 3-

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

APR 2 1974

In the Matter of WILLIAM NORTON & CO., INC. 8-11821 MARSHALL & CO. 8-6420 C.W. FRANKLIN & CO., INC. 8-16648 WILLIAM NORTON ELINORE NORTON MORRIS COHEN FRANK WOLF NORMAN POLTORACK IRENE MORGAN	ORDER FOR PUBLIC PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTIONS 15(b) AND 15A OF THE SECURITIES EXCHANGE ACT OF 1934

I

The Commission's public official files disclose that:

A. William Norton & Co., Inc. ("Norton & Co."), was previously known as William Norton & Co., 120 Wall Street, New York, New York, and is registered with the Commission pursuant to the provisions of Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") as a broker-dealer in securities and has been so registered since December 26, 1963. Norton & Co. is a member of the National Association of Securities Dealers, Inc. ("NASD"), a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act.

B. Marshall & Co. ("Marshall & Co."), 150 Broadway, New York, New York, is registered with the Commission pursuant to the provisions of Section 15(b) of the Exchange Act as a broker-dealer in securities and has been so registered since March 5, 1958. Marshall is a member of the NASD, a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act.

C. G.M. Franklin & Co., Inc. ("Franklin & Co."), 140 Broadway, New York, New York, is registered with the Commission pursuant to the provisions of Section 15(b) of the Exchange Act as a broker-dealer in securities and has been so registered since July 14, 1971. Franklin is a member of the NASD, a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act.

D. William Norton ("Norton") was the past president, director and controlling owner of Norton & Co., until the sale of the firm in November, 1972.

E. Elinore Norton ("Mrs. Norton"), was the past secretary, treasurer, director and part owner of Norton & Co., until November, 1972.

F. Morris Cohen ("Cohen") is the sole proprietor of Marshall & Co.

G. Frank Wolf ("Wolf") is the president of Franklin & Co.

H. On May 23, 1972, the Commission declared effective a registration statement (File No. 2-40945) covering 300,000 shares of Designcraft Jewel Industries, Inc., at $11.25 per share. Norton & Co. was named as the underwriter of such offering.

I. On August 3, 1972 the Commission declared effective a registration statement (File No. 2-44005) covering 210,000 shares of Atlantic Controls, Inc., at $4.00 per share. Norton & Co. was named as the underwriter of such offering.

J. On June 18, 1971 the Commission declared effective a registration statement (File No. 2-29726) covering 215,000 shares of Berkley Bio-Engineering, Inc., at $8.00 per share. Norton & Co. was named as the underwriter of such offering.

K. On June 24, 1971 the Commission declared effective a registration statement (File No. 2-36849) covering 100,000 shares of Howard International, Inc., at $5.00 per share. Norton & Co. was named as the underwriter of such offering.

L. On October 7, 1969 and June 10, 1971 the Commission declared effective registration statements (File Nos. 2-32314 and 2-39782) covering 191,000 and 250,000 shares of National Paragon at $11.00 and $13.25 per share, respectively. Norton & Co. was named as the underwriter of such offerings.

M. On August 31, 1971 and August 23, 1972 the Commission declared effective registration statements (File Nos. 2-39837 and 2-44304) covering 100,000 and 210,000 shares of Pacesetter Industries, Inc., at $4.00 and $35.00 per share, respectively. Norton & Co. was named as the underwriter of such offerings.

N. On July 11, 1972 the Commission declared effective a registration statement (File No. 24 SF-3874) covering 100,000 shares of Ramparts General, Inc. at $4.00 per share. Franklin & Co. was named as the underwriter of such offering.

II

As a result of an investigation, the Division of Enforcement has obtained information which tends to show and it alleges that:

A. Irene Morgan ("Morgan") from on or about January 1, 1961 to on or about June 1966 was employed as a registered representative with the firm of Norton & Co.

B. Norman Poltorack ("Poltorack") is a cousin of Norton and was president of Koncal Corp., a New York coporation located at 76 Beaver Street, New York, New York.

C. Mrs. Norton, in addition to the positions she held as described in Paragraph I, letter E above, was a full-time employee of Norton & Co. with overall responsibility for the maintenance of the books and records of the firm.

D. During the period from on or about January 1, 1970 to on or about March 31, 1973, Norton & Co. wilfully violated and Norton wilfully aided and abetted violations of Section 5(b)(2) of the Securities Act of 1933 ("Securities Act") in that Norton directly and indirectly carried and caused to be carried through

the mails and in interstate commerce, the common stock of Pacesetter Industries, Inc., National Paragon, Inc., Howard International, Inc., Berkley Bio-Engineering, Inc., and Atlantic Controls, Inc., among others, for the purpose of sale and for delivery after sale without such securities being accompanied or preceded by a prospectus meeting the requirements of sub-section A of Section 10 of the Securities Act, in that said prospectuses failed to disclose material facts concerning the true manner in which the offerings would be conducted, including, but not limited to:

(1) the lack of a bona fide intention to distribute said securities;

(2) the placing of said securities in accounts controlled by Norton; and

(3) that Norton & Co., through the aforesaid controlled accounts would bid for and purchase these securities prior to the completion of the distribution.

E. During the period from on or about April, 1972 to on or about May 31, 1972, Norton & Co. wilfully violated and Norton wilfully aided and abetted violations of Section 5(b)(2) of the Securities Act in that Norton directly and indirectly carried and caused to be carried through the mails and in interstate commerce, the common stock of Designcraft Jewel Industries, Inc. for the purpose of sale and for delivery after sale without such security being accompanied or preceded by a prospectus meeting the requirements of sub-section A of Section 10 of the Securities Act, in that said prospectuses failed to disclose material facts concerning the true manner in which the offering would be conducted, including, but not limited to:

D.

(1) the lack of a bona fide intention to distribute;

(2) the fact that Norton & Co., through accounts controlled by Norton, would bid for and purchase these said securities prior to the completion of the distribution; and

(3) the failure to disclose the existence of a fraudulent trading market through which Norton & Co. depressed the offering price of Designcraft Jewel Industries, Inc. and subsequently disposed of Designcraft Jewel Industries, Inc. stock to members of thepublic at inflated prices in an after-market which was not free, open, competitive, or governed by the laws of supply and demand, but was instead entirely a creature of manipulation and artifice.

F. During the period from on or about January 1, 1970 to on or about March 31, 1973, Norton & Co. and Norton, aided and abetted by Marshall & Co., Franklin & Co., Wolf, Cohen, Poltorack and Morgan, violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that said persons, in offering, selling, purchasing and effecting transactions in securities, namely, the common stock of Designcraft Jewel Industries Inc., directlyand indirectly, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in transactions, acts, practices and a course of business which would and did operate as a fraud and deceit upon purchasers and prospective purchasers of such securities. As part of the aforesaid conduct and activities, said persons, among other things, would and did:

(1) purchase, offer to purchase, sell, offer to sell and effect transactions in the above-named securities by and through accounts allegedly of customers when, in fact, such offers and transactions were being made by Norton and said accounts were being used as trading accounts for Norton & Co. and Norton and, in connection therewith, failed to disclose to other purchasers, by confirmations or otherwise, that Norton & Co. and Norton had a beneficial interest in and control of said accounts;

K. (1) On June 4, 1974 the Commission declared effective a

(2) effect a series of transactions designed to artificially depress and then stimulate activity in and the market price for Designcraft common stock in order to induce the purchase or sale of the above common stock by others;

(3) induce brokers and dealers and members of the public to purchase and sell Designcraft common stock at prices which:

(a) were arbitrary; and

(b) bore no relationship to the true market value of the stock;

(4) dominate, control and manipulate the market in Designcraft common stock;

(5) cause purchase orders to be placed with various brokerage firms in order to create a ready market for the shares being offered to the public;

(6) fail to disclose to their customers and to other broker-dealers that the market in the common stock of Designcraft was not a free, open and competitive market, governed by the laws of supply and demand, but was instead entirely a creature of manipulation and artifice;

(7) fail to disclose that the prices at which Designcraft common stock was bought and sold were totally unrelated to the true value of such stock; and

(8) use the existence of this fraudulent trading market to purchase Designcraft stock at depressed prices and then sell and otherwise dispose of the Designcraft stock in their possession to members of the public at inflated prices.

G. During the period from on or about January, 1970 to on or about March 31, 1973, Norton & Co. and Norton, aided and abetted by Franklin & Co., Marshall & Co., Wolf, Poltorack and Morgan, wilfully violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in that while participating in a distribution of the common stock of Pacesetter Industries, Inc., National Paragon, Inc., Howard International, Inc., Berkley Bio Engineering, Inc., Ramparts General and Designcraft, among others, they bid for and purchased

such securities for accounts in which they had a beneficial interest and induced other persons to purchase such securities prior to completing their participation in said distribution.

II. During the period from on or about January 1, 1970 to on or about March 31, 1973, Norton & Co. wilfully violated and Norton and Mrs. Norton wilfully aided and abetted the violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Norton & Co. failed to accurately maintain certain of its books and records, including, but not by way of limitation:

(1) blotters containing an itemized daily record of purchases and sales of securities, receipts and deliveries of securities, receipts and disbursements of cash and other debits and credits;

(2) ledgers reflecting all assets and liabilities, income and expense and capital accounts;

(3) ledger accounts itemizing separately as to each cash and margin account of every customer and of Norton & Co. and partners thereof, all purchases, sales receipts, and deliveries of securities and commodities for such account and other debits and credits to such account;

(4) memoranda of each purchase and sale of securities for the account of Norton & Co.; and

(5) records with respect to each cash and margin account with Norton & Co. containing the name and address of the beneficial owner of such account and, in the case of a margin account, the signature of such owner.

I. During the period from on or about January 1, 1970 to on or about March 31, 1973, Norton & Co. wilfully violated, and Norton and Mrs. Norton wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder in that they failed to preserve such accounts, correspondence, memoranda, papers, books and other records as are required to be preserved pursuant to the aforementioned Section and Rule.

J. During the period from on or about May, 1972 to on or about August, 1972, Norton & Co. wilfully violated and Norton wilfully aided and abetted violations of Section 11(d) of the Exchange Act in that Norton arranged for the extension or maintenance of credit to customers for the purchase of securities, namely Designcraft and Atlantic Controls, Inc., which were part of a new issue, in which Norton & Co. participated as a member of a selling syndicate or group.

K. During the period from on or about January 1, 1970 to on or about March 31, 1973, Norton & Co. wilfully violated, and Norton and Mrs. Norton wilfully aided and abetted violations of, Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder, in that Norton & Co. effected transactions in the common stock of Pacesetter Industries, Inc., National Paragon, Inc., Howard International, Inc., Berkley Bio Engineering, Inc., Ramparts General, Designcraft Jewel Industries, Inc. and Atlantic Controls, Inc., among others, with and for the accounts of customers without, at or before the completion of each such transaction, giving or sending to every such customer a written confirmation correctly disclosing the capacity in which Norton & Co., acted and with respect to transactions effected as agent, the actual amount of commission or other remuneration received or to be received in connection with the transaction.

L. While engaged in the activities as set forth or referred to in paragraphs A through J of Section II hereof, Norton & Co., Marshall & Co., Franklin & Co., Norton, Mrs. Norton, Cohen, Wolf, Poltorack and Morgan, singly and in concert, directly and indirectly, made use of the mails and means and instruments of transportation and communication in interstate commerce and of the means and instrumentalities of interstate commerce.

[illegible] or about March [illegible], 1973, Norton & Co. and Norton by [illegible] Marshall & Co., Wolf, [illegible] wilfully [illegible]

III

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors that public proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true, and in connection therewith, to afford respondents an opportunity to establish any defense against said allegations;

B. What, if any, remedial action is appropriate in the public interest pursuant to the statutes administered by the Commission, including Section 15(b) and 15(A) of the Exchange Act.

IV

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held at a time and place to be fixed and before an administrative law judge to be designated by further order as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that each party file an answer to the allegations contained in the Order for Proceedings within 15 days after service upon him of said order as provided by Rule 7 of the Commission's Rules of Practice.

If any party fails to file the directed answer or fails to appear at a hearing after being duly notified, said paty shall be deemed in default and the proceedings may be determined against such party upon consideration of such Order for Proceedings, the allegations of which may be deemed to be true.

This Order shall be served upon Norton & Co., Marshall & Co., Franklin & Co., Norton, Mrs. Norton, Cohen, Wolf, Poltorack and Morgan, personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision upon this matter, except as witness or counsel in proceedings held pursuant to notice. This proceeding is not "rule making" within the meaning of Section 4(c) of the Administrative Procedure Act and is not deemed subject to the provisions of that Section delaying the effective date of any final Commission action.

By the Commission.

George A. Fitzsimmons

George A. Fitzsimmons
Secretary

STATE OF NEW YORK)
) SS.:
COUNTY OF NEW YORK)

ENNA PADIN, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 83-20 Britton Avenue, Elmhurst, New York. That on the 3rd day of July 1974 deponent served one copy of Joint Appendix and two copies of Plaintiff-Appellant's Brief upon Feldshuh & Frank, Attorneys for Defendant-Appellee, William Norton & Company, Inc., at 144 E. 44th Street, New York, N. Y. 10017 and one copy of Plaintiff-Appellant's Brief and Joint Appendix upon Galpeer, Altus & Karp, Attorneys for defendant Designcraft Jewel Industries, Inc., at 245 Park Avenue, New York, N.Y. 10017 by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in an official depository maintained at 41 East 42nd Street, New York, N.Y. 10017 under the exclusive care and custody of the United States Post Office Department within the State of New York.

Enna Padin

Enna Padin

Sworn to before me this 3rd
day of July, 1974.

Stanley L. Kaufman

STANLEY L. KAUFMAN
Notary Public, State of New York
No. 31-7183000
Qualified in New York County
Commission Expires March 30, 1974

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NO. 74-1573-A

H. PERINE,

Plaintiff-Appellant

-against-

WILLIAM NORTON & COMPANY, INC., WILLIAM NORTON, ELINORE NORTON and DESIGNCRAFT JEWEL INDUSTRIES, INC.,

Defendants

On Appeal From United States District Court
For The Southern District of New York

AFFIDAVIT OF SERVICE

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